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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

TENNY ROSS, *Petitioner*

v.

UNITED STATES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

ROBERT H. MYERS
817 Munsey Bldg.
Washington 4, D. C.
Attorney for Petitioner

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Petitioner prays that a writ of certiorari be issued to review the judgment of the United States Court of Claims entered in the above-entitled case.

CITATION TO OPINION BELOW

The Opinion of the United States Court of Claims is unreported. A copy of its Opinion, Judgment, Findings of Fact and Conclusions of Law is printed as Appendix "A" to this petition.

JURISDICTION

The Judgment was entered June 3, 1959. The jurisdiction of the Court is invoked under Title 28 U.S.C. Sections 1255(1) and 2101(c).

QUESTION PRESENTED

When the petitioner, a shareholder of The Washington Loan and Trust Company of Washington, D. C., received money in addition to stock pursuant to the consolidation of The Washington Loan and Trust Company and The Riggs National Bank of Washington, D. C., was such money taxable to the petitioner as a gain under Section 356(a)(1)(B) of the Internal Revenue Code of 1954, or as a dividend under Section 356(a)(2) of the Internal Revenue Code of 1954?

STATUTES INVOLVED

Internal Revenue Code of 1954:

"Sec. 356. Receipt of Additional Consideration.

"(a) Gain on Exchanges.—

"(1) Recognition of gain.—If—

"(A) section 354 * * * would apply to an exchange but for the fact that

"(B) the property received in the exchange consists not only of property permitted by section 354 * * * to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

"(2) Treatment as dividend.—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized

under paragraph (1), shall be treated as gain from the exchange of property."

(26 U.S.C. 1952 ed., Supp. II, Sec. 356.)

Sections 302, 316, 354, 1001 and 1002 are printed in Appendix "B" below.

STATEMENT

The petitioner claims judgment for $210 tax and $5.55 interest thereon, assessed as a deficiency upon his individual federal income tax return for the calendar year 1954. The petitioner owned 450 shares of capital stock of The Washington Loan and Trust Company. In accordance with the terms of an Agreement of Consolidation, the petitioner in 1954 surrendered his 450 shares of Trust Company stock and received 56 shares of the capital stock of the consolidated bank (The Riggs National Bank of Washington, D. C.), a trustee's certificate for 2 8ths of a share, and $2,025 in cash. The cash payment received was reported by the petitioner as a capital gain under § 356(a)(1)(B) of the Internal Revenue Code. The Commissioner of Internal Revenue treated the cash as a taxable dividend and assessed a deficiency against the petitioner, which deficiency petitioner paid and filed a claim for refund and in due course filed a petition with the United States Court of Claims which petition was ordered to be dismissed in the Opinion below.

REASONS FOR GRANTING THIS WRIT

The decision below, if unreviewed, establishes as a precedent a pattern for application of Sec. 356 (a)(1)(B) which completely destroys and nullifies the whole effect and purpose of that often relevant provision.

If that provision does not apply to a case such as the present, to what does it apply? As the court below in its own earlier decision in the *Idaho Power Co.* case, 161 F. Supp. 807, so well put it:

> "If Congress meant merely to say that any boot money at all paid out of earnings should be a taxable dividend, it used a verbose and complicated way of saying it."

The instant case is typical of the many instances where relative values of stock involved in a reorganization cannot be expressed in terms of full shares or even in terms of reasonable fractions of shares. Under a decision such as that in the instant case, the money or boot would be fully taxed as a dividend, rather than as a capital gain, only because legitimate business reasons preclude the issuance of unreasonable fractional shares.

Section 354 of the Internal Revenue Code of 1954 specifies that in reorganizations, such as mergers or consolidations, gain or loss is not recognized if securities or stock are exchanged solely for securities or stock. Section 356(a)(1)(B) provides that if "*money*" is also received then a gain shall be recognized not in excess of the sum of such "*money*". Section 356(a)(2) further provides that if the payment has the effect of the distribution of a dividend, then such money is to be taxed as a dividend.

After the decision of this court in *Commissioner v. Estate of Bedford*, 325 U.S. 283, respondent developed a theory—by way of an extension of the *Bedford* decision—that if there are earnings and profits, i.e., unless the corporation is insolvent or has no earnings and profits, then *all* payments of money or boot become dividends and are taxable as such.

As indicated above, the court below rejected this theory in the *Idaho Power Co.* case and stated that dividend equivalence is determined "on the facts in each case".

However, the court below did not adhere to the facts as determined by its own Commissioner. The facts were that the competitive negotiations leading to merger and exchange of shares and money were at all times on a business basis and at arm's length; that The Riggs National Bank of Washington, D. C. —against the wishes of petitioner and other stockholders—made its exchange offer in terms of stock plus cash because The Riggs National Bank concluded that for its own purposes a stock-for-stock offer would create for The Riggs National Bank unreasonably small fractional shares in the local market; the offer which was made by The Riggs National Bank to petitioner was made in competition with a genuine competitive cash offer of an independent third banking corporation; that the $450,000 paid in trust prior to the consolidation by The Riggs National Bank for payment, in part, to petitioner came from the profit and loss account of The Riggs and that the assets of the consolidated bank did not include the $450,000 paid by The Riggs.

Yet the court characterized the transaction differently. It said

> "* * * the $450,000 was identified as funds earned and owned by the Trust Company. They were as completely identified as was the one-eyed man who was suspected of cheating in the early days' western poker game. One of the victims finally said, 'Now, I am not going to call any names, but if the man around this table who has been cheating doesn't stop, I am going to shoot out his other eye'."

All of the 42 Findings of Fact (see Appendix "A") of the Commissioner are exactly to the contrary, excepting No. 23, which states:

> "As of the close of business October 1, 1954, the Trust Company had earnings and profits of $909,671.49."

Legislative history clearly demonstrates that Congress was concerned with evasions and avoidance of tax. The roots of Section 356 extend back to the Revenue Act of 1918, but the specific provision was introduced by Section 203(d)(2) of the Revenue Act of 1924.

The House Committee in its Report on the Revenue Bill of 1924 (Rept. No. 179, 68th Cong. 1st Sess., pp. 14-15) explained the necessity for Sect. 203(d)(2) as follows:

> "(2) There is no provision of the existing law which corresponds to paragraph (2) of subdivision (d). This subdivision provides that any amount distributed by a corporation in connection with a reorganization which has the effect of a taxable dividend shall be taxed as a dividend and not as a taxable gain.
>
> "The necessity for this provision may best be shown by an example: Corporation A has capital stock of $100,000, and earnings and profits accumulated since March 1, 1913, of $50,000. If it distributes the $50,000 as a dividend to its stockholders, the amount distributed will be taxed at the full surtax rates.
>
> "On the other hand, corporation A may organize corporation B, to which it transfers all its assets, the consideration for the transfer being the issuance by B of all its stock and $50,000 in

> cash to the stockholders of corporation A in exchange for their stock in corporation A. Under the existing law, the $50,000 distributed with the stock of corporation B would be taxed, not as a dividend, but as a capital gain, subject only to the 12½ per cent rate. The effect of such a distribution is obviously the same as if the corporation had declared out as a dividend its $50,000 earnings and profits. If dividends are to be subject to the full surtax rates, then such an amount so distributed should also be subject to the surtax rates and not to the 12½ per cent rate on capital gain. *Here again this provision prevents evasions.*" (Emphasis supplied.)

In the same House Report is contained the separate "Views of Eleven Republicans" in support of the House Bill, and it is stated:

> "Changes Designed to Prevent the *Avoidance* of the Income Tax.
>
> "(2) The provisions of the reorganization section have been rewritten to prevent the use of the section to escape proper taxation * * * by distributing as capital gains what are in effect dividends out of earnings." (Id. pp. 36, 44.) (Emphasis supplied.)

The following results logically flow from the decision below:

Section 356(a)(1)(B) is eliminated from the Internal Revenue Code of 1954 excepting only if

> (i) The corporation is insolvent or had no earnings and profits, or
>
> (ii) The reorganization is a recapitalization (*Idaho Power Co.* case). Neither of these two exceptions has legislative sanction.

The question is vital to all corporations faced with reorganizations in the nature of a merger or consolidation. Unfortunately, the impact of the decision below is grossly inequitable.

A national corporation whose stock is listed on a national exchange or a corporation which has a large market for its stock is given a substantial competitive advantage. It can avoid dividend equivalence simply by issuing fractional shares.

By contrast, a local corporation whose stock is not listed on a national exchange or any corporation—listed or not on a local or national exchange—which has a thin market for its stock, for sound business reasons, may be unable to complicate its stock structure by the issuance of odd fractional shares. It is thus foreclosed from protecting its stockholders because of legitimate and practical business considerations.

A perfect illustration was before the Court below. The Riggs concluded that the market would not absorb the fractions which the Commissioner determined to be something more than 5 64ths of a share and something less than 3 32nds of a share. The conclusion was that for legitimate business reasons fractional shares could not be issued. Petitioner was denied a capital gain which would have been his undisputed right if fractional shares had been issued.

Thus the decision below penalizes the stockholders of the great number of local or unlisted corporations which for perfectly legitimate business reasons in perfectly legitimate reorganizations are not able to market commercially unattractive fractional shares.

In essence, the decision permits form rather than substance to determine the tax result to the benefit of the few and to the detriment of the many.

CONCLUSION

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted.

ROBERT H. MYERS
817 Munsey Building
Washington 4, D. C.
Attorney for Petitioner